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USDOC FOR 4420/ITA/MAC/MCQUEEN, DAS LEVINE, RIGOLI  
STATE FOR EB/TPP MASSINGA, FELSING  
STATE PASS COPYRIGHT FOR TEPP  
STATE PASS USPTO FOR DUDAS, BROWNING, BOLAND, ANTHONY, NESS  
STATE PASS USTR FOR MENDENHALL, MCCOY, ESPINEL, WINTER,  
CELICO  
USDOJ FOR SUSSMAN  
DHS/CPP FOR PIZZECK  
USPACOM FOR FPA

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SUBJECT: IPR Enforcement in South China: USTR-led  
Interagency Journey into the "Heart of Darkness"

REFERENCE: A) Guangzhou 20753; B) Guangzhou 15230

(U) This document is sensitive but unclassified. Please  
protect accordingly.

11. (SBU) Summary: Following JCCT IPR Working Group meetings in Beijing, a USTR-led delegation traveled to Fujian and Guangdong provinces in late August to engage local leaders on IPR issues and raise specific areas of concern. The visits were part of the provincial review of China announced in the Special 301 Report issued on April 28, 2006. Though most of the Chinese officials stuck to Beijing's talking points, the meetings revealed differences in emphasis. Shenzhen budgets specifically for software procurement and cooperates closely with optical disc industry associations. Dongguan is more concerned with holding seminars than developing criminal cases. Fujian officials would like U.S. companies to more closely oversee their contractors and assist in counterfeit verification. Guangdong acknowledges that administrative penalties are not a deterrent and encourages closer engagement with the U.S. Chamber of Commerce. All of the Chinese enforcement agencies continue to rely on short-term campaigns and initiatives, such as the recently announced "100 Day Campaign" on copyrighted materials, despite facing increasingly organized counterfeiting rings. Visits to local counterfeit markets and discussions with U.S. industry provided further evidence that only a sustained, long-term coordinated effort will be enough to reduce overall levels of piracy. End summary.

Background on the Interagency Visit  
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12. (SBU) In an effort to pinpoint the problems in China's IPR enforcement system and develop more effective solutions, USTR has focused on regional IPR enforcement this year. The 2006 Special 301 Report spotlights Guangdong, Fujian, and Zhejiang provinces and Beijing as IPR "hot spots" and recommends more sustained, deterrent enforcement. The visit by USTR, Commerce, and Patent and Trademark officials to Fujian and Guangdong provided an opportunity for face-to-face discussion with local enforcement officials, U.S. business representatives, and first-hand glimpses of

counterfeiting markets.

¶3. (SBU) The Special 301 Report names Guangdong as the center of large-scale counterfeiting in China for goods ranging from low-cost consumer items to electronics. As one-third of China's exports pass through Guangdong, it is a crucial link in the global piracy chain. In Fujian, the report highlights widespread production of counterfeit athletic shoes, among other products. Nike, Reebok, and New Balance are all engaged in long-running legal actions in Fujian (Nike representative Bill Wei asked the Consul General to raise Nike's concern during an upcoming trip to Putian the week of September 11). Optical disc piracy is common throughout Guangdong and Fujian.

¶4. (SBU) Attending on the Chinese side at most of the meetings were representatives from the Intellectual Property Office (IPO), Copyright Bureau, Culture Bureau, Administration for Industry and Commerce (AIC), and Foreign Affairs Office (FAO). No representatives from the Public Security Bureau (PSB), Customs, or Procuratorate accepted invitations to meet. Representing USTR were Stan McCoy, Chief Negotiator on IPR, and Audrey Winter, Deputy Assistant USTR for China. Lisa Rigoli, International Trade Specialist represented the Department of Commerce; Tim Browning participated for the Patent and Trademark Office. Guangzhou Econ/Pol officers and staff accompanied the delegation.

Fujian Province: Shoe Central

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¶5. (U) Bai Jingzhao, Director of the Fujian Copyright Bureau, told the U.S. delegation that Fujian has encouraged IP protection through progressive legislation and strong

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enforcement. Eighty percent of Fujian counties now have a Copyright Bureau. All computer manufacturers in Fujian must preinstall legitimate software. Copyright officials inspect government offices to verify the use of legitimate software and are just beginning to promote legal software use in large private enterprises. Fujian has also implemented national police campaigns, including the "100 Days Campaign" against optical disk piracy, the "No Fakes" joint campaign with retailers, and the establishment of one-stop IPR Complaint Centers.

¶6. (U) An official from the Fujian AIC told the team Fujian administrative authorities had transferred 26 trademark cases to the police in 2005, reportedly the second largest number in China (Note: this number did not match official statistics published by the central government, which indicated only 5 trademark referrals in 2005. End note). Fujian officials reported that they had transferred 10 cases involving U.S. rights-holders since the end of 2004, one of which involved Nike. In response to questions about how to improve enforcement against counterfeit athletic shoes, the official noted that the shoe industry is difficult to monitor because of the preponderance of OEM enterprises, usually Taiwan- or Hong Kong-owned, that manufacture for foreign companies. He recommended that U.S. companies or industry groups more closely monitor their contractors and also set up verification teams in Fujian to assist officials in identifying counterfeit products.

¶7. (U) To highlight Fujian's stake in an effective IP protection regime, Bai raised the example of Dehua, a Fujian county of 300,000 residents that has a long history of manufacturing ceramics and sculpture products. Dehua enterprises hold numerous design patents and residents have per-capita incomes higher than the provincial average. Dehua enterprises have even sued Italian and Spanish manufacturers for infringing their patents and copyrights.

¶8. (U) USTR McCoy encouraged Fujian officials to undertake more ex-officio actions on behalf of U.S. rights holders,

particularly small and medium-sized enterprises, for example Wisconsin ginseng farmers. He called attention to counterfeiting of the athletic shoe trademarks of companies such as New Balance. He also noted that the U.S. delegation's visit coincided with the start of the fall school semester, and urged local officials to crack down on pirated textbooks. The U.S. team encouraged Fujian officials -- and other officials in subsequent meetings -- to open a channel of communication through the U.S. Consulate in Guangzhou to provide useful data on enforcement and examples of successes.

#### Guangdong Province: We Know There's a Problem

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¶9. (U) Guangdong Deputy Secretary General Luo Ou noted that Guangdong IP officials have targeted specific cities for enforcement efforts during the past five years: Guangzhou, Shenzhen, Shantou, Jieyang, and Chaozhou. Civil IPR courts in 21 municipalities and eight counties in Guangdong have accepted an accumulated total of 2,800 cases. Luo noted that some lower-level courts in Guangzhou and Shenzhen have begun accepting IP cases in a pilot program to reduce case backlog and that the province established three IPR Complaint Centers. In addition, Guangdong has increased budget funding for its court system.

¶10. (U) USTR McCoy emphasized that U.S. industry remains concerned about a lack of counterfeiting and piracy cases transferred to the police for criminal investigation, due in large part to inconsistent standards of valuation for seized infringing products. Luo acknowledged that in some cases penalties for infringement are not severe enough to deter counterfeiting, and agreed that the number of criminal cases needs to be increased. With respect to copyright piracy, Luo mentioned that a total of 200 optical disc production lines have been confiscated by Guangdong officials since

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copyright enforcement began in May 1996. He added that many of the pirated CDs and DVDs sold in Guangdong are imported from nearby Asian countries, such as Vietnam. McCoy called on the provincial government to help address this problem by encouraging the Shenzhen optical disc testing facility to share exemplars with the international library maintained by IFPI. He also raised copyright industry concerns about book piracy and government use of software. McCoy encouraged Guangdong officials to continue working with the U.S. Chamber of Commerce on training and benchmarking initiatives (see reftel A on a recent IP seminar co-hosted by the U.S. Chamber and Guangdong authorities).

#### Shenzhen City: More Than Talk

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¶11. (U) Li Ping, Deputy Secretary General of Shenzhen, former head of the Shenzhen IPO, and current chairman of Shenzhen's leading group on IPR, acknowledged that Shenzhen's growing reliance on the high-tech sector meant that the city must create an effective IP protection environment. He mentioned that he personally read USTR's Special 301 Report entry on China and was aware of foreign industry concerns. Li noted that four of the nine heads of IP agencies present at the meeting were educated in the West, three in the United States. Li explained that Shenzhen has unique legislative power because of its status as a special economic zone, and its leaders have put into place IP laws that are more stringent than national laws. This is particularly in the area of software and optical discs, which are the focus of enforcement in the city.

¶12. (U) Li said Shenzhen has a specific budget of RMB 14 million for the purchase of legitimate software in government offices. (Note: This was the first time any of the U.S. participants had heard of a specific budget for the procurement of legitimate software. End note). He noted

that IPO and MOFCOM officials will be at the upcoming Shenzhen High-Tech Fair to verify that all products are legitimate, then will issue certificates to those who pass inspection.

¶13. (U) Li added that the number of cases transferred for criminal investigation in Shenzhen has increased each year. Su Huijian, director of Shenzhen's Culture Bureau, said his office has transferred 145 copyright-related cases to criminal authorities since 2004. All of cases were charged under the illegal business law, because the Cultural Bureau itself does not have the authority to bring charges under IPR statutes. Su expressed hope that future cases could be charged under the copyright law if the Cultural Bureau's operating authorities were changed. (Note: The illegal business law includes tougher penalties for infringers and is less burdensome in terms of evidence collection. The Copyright Bureau is authorized to bring charges under the IPR statutes. End note).

¶14. (U) USTR DAUSTR Winter said she looked forward to improved coordination between industry associations and the national optical disc forensics lab located in Shenzhen. The lab holds China's only complete exemplar library of optical discs produced in China; it is the only lab housing sound spectrogram and optical media "fingerprinting" equipment to conduct forensic analysis. Though the lab did permit a USG visit on May 19 (reftel B), U.S. industry faulted the lab for a lack of transparency and its unwillingness to contribute exemplars to a global database. Li said the lab is under the authority of the central-level Ministry of Public Security, and the city of Shenzhen has minimal say in its operations, though he promised that the IPO and Copyright offices would raise with lab staff and the MPS in Beijing the issue of contributing to a global exemplar library.

Dongguan City: Turning a Blind Eye

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¶15. (U) Liang Bing, Deputy Secretary General of Dongguan, commented that Dongguan's robust enforcement has meant relatively low piracy. Since Dongguan intends to shift from being a center of low-cost manufacturing to a "city of innovation," it places great importance on IP protection. He noted that Dongguan, in accordance with national mandates, has set up an IPR Complaint Center and an experimental lower-level court for IP cases. Lian Xibo, head of the Dongguan IPO, commented that foreign companies do not always follow correct procedures in filing administrative cases. USTR McCoy responded that industry has expressed concern that different localities in China use different procedures for case filing, and a higher level of transparency would help both sides. He also said that Dongguan can improve its IP enforcement reputation with U.S. industry by increasing the number of ex-officio actions on behalf of U.S. companies.

¶16. (U) The Dongguan authorities did not provide any data on case transfers, but claimed the number of such cases is increasing. Lu Jingna, head of Dongguan AIC, said the number of criminal cases involving foreigners is "few," in part because such companies are better at protecting their own IPR by themselves. Liang said that Japanese enterprises put together a catalog of major Japanese trademarks and provided copies to enforcement authorities, helping them to better protect Japanese marks. Liang opined that the reason Dongguan sees few IP-related criminal cases is that few infringers operate in Dongguan and little piracy takes place there. Regarding optical disc piracy, Liang said Dongguan does not produce any optical discs, legitimate or fake.

Industry Views: An Increasingly Complex Problem

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¶17. (SBU) In meetings with the U.S. delegation in Shenzhen and Guangzhou, U.S. companies voiced their frustrations with local IP enforcement authorities, whom they say routinely partner with IPR violators, are susceptible to corruption, are outmatched by increasingly sophisticated counterfeit rings, and attach little importance to trade secrets cases. Sam Ho, MPA's Director of Operations for Greater China, has successfully cooperated with the Shenzhen and Guangzhou Culture Bureau, but said Dongguan authorities are not completely honest in their claim to low piracy rates. (Note: Numerous industry contacts have told us that Dongguan officials are guilty of local protectionism and are notoriously corrupt. End note). Shenzhen in particular has shown great improvement in recent years, but Ho noted that optical disc warehouses have unfortunately begun to move from Shenzhen to Dongguan. John Groves, Director of IP in Asia for Emerson, said the situation has "deteriorated" during that past two years, with counterfeiters moving up the value chain by copying high-end products such as USD 500-1000 petrochemical plant pressure valves. He said authorities are generally cooperative, but lack resources and expertise to deal with the problem. Emerson has applied for certification as a "famous trademark" in China in the hope that it will see improved responsiveness on IP issues.

¶18. (SBU) Several U.S. companies said they have been the victim of employees who steal trade secrets or violate non-compete agreements. A representative from HR management firm Hewitt Associates said China's draft labor contract law improves the situation somewhat, but does not provide deterrent remedies. Moreover, few companies even try to sue employees who steal trade secrets because of the low rate of success in the court system. In the case of a bicycle manufacturer (Dahon), police claiming that no harm had occurred refused to get involved in a case in which a former senior engineer blackmailed the company by threatening to divulge data to competitors. Emerson currently has a case pending in Shenzhen involving an employee who stole company secrets and set up a competing enterprise.

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¶19. (SBU) Harley Seyedin, President of AmCham-South China, said the emergence of large department stores in the area

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has improved the IPR environment somewhat, as they have a stronger interest in controlling the products they sell in order to protect their own reputation. Nevertheless, he said, "substantial underreporting" of IP infringement exists because U.S. companies do not always initially see it as a threat and because they fear damaging relations with government officials. In addition, U.S. companies in the region are faced with a host of other challenges that are more pressing than IPR protection. AmCham-South China recently released a survey of U.S. companies in the region that found regulatory issues, local competition, and skilled and unskilled labor shortages as greater challenges than IPR protection.

Impressions from Market Visits: Business as Usual

¶20. (U) The U.S. delegation visited a number of markets in Fuzhou, Shenzhen, and Guangzhou and found varying amounts of counterfeit products present. Some of the markets prominently displayed blatantly counterfeit merchandise, others stored their fakes in back rooms but displayed non-infringing plastic models of branded goods or offered catalogs with the stock available within a few minutes. Other markets appeared largely absent of fakes. Guangzhou's leather market -- which fills a number of large shopping-mall sized buildings on either side of a main thoroughfare -- did not have its usual abundance of fake purses, wallets, and bags on display. It soon became apparent, however, that



the vendors were expecting a raid by AIC that very day and had hidden counterfeit products from view.

¶21. (U) Vendors at a nearby shoe market openly sold fake Nike, New Balance, and Reebok products as well as those sporting Disney and Sesame Street characters. Some of the vendors were not interested in selling individual items, preferring instead to deal with large, wholesale orders. Fake Levi's, Polo, Guess, and Snoop Dogg clothes were widely available at a Guangzhou clothing market. Some of the clothing, particularly winter coats, appeared to be high-quality, genuine products being sold at low prices. This is likely the result of "third-shift" manufacturing, in which factories produce extras to sell on the side. Also for sale was clothing, particularly jeans, without brand labels. At a nearby building, however, numerous stores are willing to produce large quantities of counterfeit labels, buttons, tags, and bags for customers.

¶22. (U) In addition, foreign buyers -- particularly Africans, Middle Easterners, and South Asians -- work in Guangzhou as wholesale purchasers and shippers for enterprises in their home countries. This phenomenon has broadened the global reach of China's counterfeiting industry. Indeed, at one of many booths at a Guangzhou watch market that openly sold fake Rolex watches, Mont Blanc pens, and Sony MP3 players, a buyer from South Asia was negotiating a purchase of watches numbering in the tens of thousands.

Comment: It's a Regional Issue

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¶23. (SBU) This trip drove home the fact that IPR enforcement in China is as much a regional issue as a national issue. Even within provinces, particular cities and particular agencies are more effective and engaged than others in IPR protection. Shenzhen is an example of a city that increasingly takes IPR enforcement seriously, for its own sake as much as for its foreign enterprises. It faces well-organized opposition that tracks visitors, including the members of this interagency team, by photographing them and comparing their photos to databanks of known enforcement agents. This practice extends to other cities as well. Shenzhen administrative enforcement agents have been physically threatened by vendors at retail markets. Dongguan, on the other hand, showed an unsettling degree of nonchalance about IPR enforcement that seems to signal

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systemic problems. Nevertheless, this visit by USTR, USDOC and PTO undoubtedly brought home the message to local officials in Fujian and Guangdong that the USG is closely watching their IPR enforcement actions and will duly note any improvements or failures.

¶24. (SBU) Chinese officials continue to rely on short-term campaigns and initiatives to address what has become an ingrained problem. An illustration of the challenge that Chinese IP officials face was seen during the visit to Luohu Market, in Shenzhen on the border with Hong Kong. At Luohu -- which was specifically listed in the 2006 Special 301 Report and which Shenzhen Deputy Secretary General Li termed "our headache" -- vendors do not openly display counterfeit products but rather lead you to hidden rooms in nearby buildings that are loaded with fake goods. In one instance, a roaming vendor offered to lead the U.S. delegation to a hidden store but was chased off by a security guard. Five minutes later, the same vendor was back in the same place, apologizing for the inconvenience and urging the group to accompany him.

¶25. (U) USTR has cleared this cable.

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